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FOREIGN DIRECT INVESTMENT IN AZERBAIJAN

INVESTMENT CLIMATE AND PROSPECTS IN AZERBAIJAN

Situated at the crossroads of East and West –the South Caucasus region, the Republic of Azerbaijan regained its independence in 1991. As the other former socialist countries, Azerbaijan is facing a number of problems of transformation of national economy.

The recently elaborated economic policy of Azerbaijan has put strong emphasis on liberalisation, private sector development and transformation of the country's planned economy to a market-oriented system.

The economy of Azerbaijan is pretty diversified, including oil and gas production, oil-refining, engineering, metallurgy, chemical, petrochemical, light and food industries, construction materials, agriculture (cotton, tea, tobacco, silk worms, vine-growing, vegetables, fruits) and offers promising prospects for future investors.

MACROECONOMIC DEVELOPMENT

Since 1996, the economic decline has been stopped and an upward trend of the GDP growth is currently under way. In 1996 the real GDP growth was 1.3 %; it reached 5.8% in 1997, 10 % in 1998 and 7.4 % in 1999. In 2000 in comparison with the previous year, the GDP growth increased by 11.4 %. In 2000 GDP per capita amounted to \$562.3, which is more than 10.4 % in 1999. In 2000 the foreign trade turnover equals to \$3 bn. %. 63 % of the trade turnover came from exporting goods. This helped Azerbaijan to attain the positive balance of payments with \$ 680 million.

During the last years the government was successful in retaining a relatively low rate of inflation. Constituting 1600 % in 1994 it was decreased to 3 % and remains stable up to present time. Currently, the ratio of the country's budget deficit to GDP is 2 %. The portion of the Budget in GDP of Azerbaijan in 1993 constitutes 41.3 %, in 1997 – 22.4 %, in 1998 – 16.6 %, in 2000 – 15.2 %. The reduction of given indicator was followed by the appropriate reduction of the portion of budget in GDP that confirms the necessity of follow up reduction of state interference in the economy.

It is necessary to indicate that the analysis of the economy transformation of the Republic shows that the temps of growth are under the reverse dependence from scales of state regulation.

Foreign currency reserves, including the assets of the recently established Oil Fund, are more than \$ 1 bln, which in its turn equals to the country's import for a term of 6-7 months.

LEGISLATION

The tangible upheaval was achieved not only in stabilisation macroeconomic development, but also in attraction of huge foreign investment inflows into the economy. Favourable conditions are created and permanently have been improving for foreign investments. A legal framework provides good incentives for foreign investors. The completion, however, of building a legal and institutional market infrastructure is being gradually but consistently pursued. From 1992 up to the present the Milli Majlis (Parliament) of the Republic of Azerbaijan has adopted 120 top-priority laws, which regulate the reforms in economy and include Law on *Protection of Foreign Investments*, *Property Law*, *Law on Land Reform*, *Law on Privatisation of State Property*, *Law on Joint-Stock Companies*, *Law on Entrepreneurial Activity*, *Law on Bankruptcy*, *Law on Securities and Stock Exchange*, *Tax Code*, *Customs Code* and etc. Aimed at regulating effectively the economic processes in the country have been adopted a great number of decrees and resolutions of the President and decisions of the Cabinet of Ministers.

A new Tax Code entered into force in January 1, 2001. According to this Code the tax rates on all taxes have been decreased, maximum rate of the tax on income of physical persons has been decreased from 40% to 35%, rate of the tax on profits of legal entities from 30% to 27%, rate of the value added tax from 20% to 18%, calculation methods have been improved, measures of safeguard taxpayers' rights have been taken.

Since April 16, 2001, the differentiated tariff system is applied for import operations. Raw materials, goods and equipment intended for production are free from import tariffs, and goods intended for investment purposes are free from customs taxes and tariffs.

For ensuring of a favourable climate to the foreign investors irrespectively of the national belongings the law on "Protection of Foreign Investments" and the law concerning "Investment Activities" were adopted in 1992. Having successfully implemented two State Investment Programmes for a period of 1997-1999 and 1998-2000, Azerbaijan is being elaborated of the next State Investment Programme for a term of 2002-2004.

INVESTMENT INFLOWS

It is necessary to note that the levels of investments in Azerbaijan for a period of the last seven years come to \$ 9 bln, whereas \$ 6 bln is foreign investments (while nearly \$ 5 bln is Foreign Direct Investments), \$ 3 bln is domestic ones. That is the highest index among the countries with transition economy.

Main part of foreign investments is concentrated in the energy sector. Now Azerbaijan is an important link in growing business of a number of the world's leading energy companies (BP, ExxonMobil, ChevronTexaco, ElfTotalFina and etc.) in the Caspian region.

Till now Azerbaijan succeeded in signing 21 Production Sharing Agreements (PSA)-contracts on exploration its offshore oil fields, with estimated reserves of 200bln barrels of oil and 640 trl cubic ft of gas – at least 15 per cent of the world's reserves.

The share of investments in the non-oil sector is being increased. For example this ratio in 1998 constituted 39.3 %, in 1999-46.4 %, but in 2000 nearly 50 %.

PRIVATISATION

For the establishment of self-regulated market economy space for economic entities based on private ownership and free competition and restructuring of the national economy in accordance with market-economy requirements the Republic of Azerbaijan prepared in compliance with Laws of the Republic of Azerbaijan the State Programme of State Property Privatisation.

The first stage of the Programme was carried out guided with the principles of transforming the state-owned enterprises (small and medium-sized) into joint-stock companies and subsequent privatisation. As noted by observes, the indicators, at the first stage of privatisation, have not been witnessed in privatisation practise of most countries, which had already passed this process.

The second stage of the privatisation program became effective since August 10, 2000. There are 7 sale methods envisaged by the program.

On March 22 and 29, 2001 the Decree on privatisation of enterprises in industries such as telecommunications, airways, fuel and energy, machinery, chemical, poultry, as well as the Decree on

establishment of open joint-stock company "Azneftkimyamash" were signed by the President of the Republic of Azerbaijan. The decrees stipulate privatisation of state shares of nearly 450 enterprises and 21 joint ventures.

These decrees are aimed at attraction of investments to achieve efficiency of the privatised enterprises, produce competitive goods and create new jobs.

The decision to authorise public offering of enterprises by means of individual projects and investment bids as well as to ensure equal opportunities for participation of foreign and local investors in privatisation is therefore crucial.

ADMINISTRATIVE AND INSTITUTIONAL ADJUSTMENTS

Creation of the Ministry for Fuel and Energy responsible for state fuel and energy policy formulation and implementation and the amalgamation of 5 ministries and state committees (Ministry of Commerce, Ministry of Economy, Agency for Foreign Investment, Ministry for State Property; and State Committee on Antimonopoly policy and Support for Entrepreneurship) to form the Ministry for Economic Development is a – step towards the administrative reform and separation of policy from commercial functions.

It is essential that Azerbaijan nominates Minister for Transport and ensures full implementation of the relevant Presidential Decree.

CONCLUSION

In spite of difficulties of transitional nature, the continued occupation of 20% of its territory by Armenia and the existence of more than million refugees and internally displaced persons in the country, Azerbaijan has achieved to become one of the most successful among the NIS countries in terms of political and economical stability.

It is increasingly recognised that the present stage of the world development is characterised by the processes of globalisation and regionalisation. Azerbaijan exerts all efforts to make its contribution to these processes. Using its advantageous geostrategic location, rich natural potential and human resources, Azerbaijan is actively engaged in restoration of the Great Silk Road, creation of the EU-sponsored Europe-Caucasus-Asia transport corridor (TRACECA), the Secretariat of which is based in Baku, and the further development and transportation of hydrocarbon resources of the Caspian Basin to the world markets.

Our country is ready to play connecting role in realisation of prospective trans-regional projects, encouraged by international organisations. Cooperation within the framework of international organisations constitutes one of the most significant guidelines of Azerbaijan's foreign economic policy. Azerbaijan is a member of more than twenty international economic organisations and has observer status at the World Trade Organisation.

In conclusion, our strong efforts to improve a favourable environment for investors, both foreign and domestic, continue. Involvement of investors in the privatisation process is one of the positive aspects of carrying out reforms in Azerbaijan. Hence, the doors of Azerbaijan are open both to local entrepreneurs and foreign investors to reap the full benefits of FDI for both sides.